

HARMONISATION EFFORTS IN THE FIELD OF ACCOUNTING OF PUBLIC SECTOR

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Abstract

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Increasing requirements for financial reporting of public sector led to a need to create a system that would provide relevant and reliable information for management of accounting entities of public sector and also to increase the quality of accounting and financial statements of public institutions. The International Public Sector Accounting Standards Board (IPSASB) is therefore creating high-quality financial reporting standards for public sector (IPSAS). Paper points out the ongoing reform of accounting in the field of public finances in the Czech Republic, where there are substantial changes in accounting rules and it also introduces new accounting methods. Regarding the fact that accounting of public sector is nowadays accounting system perhaps with the greatest potential of development, paper highlights the differences in financial reporting in accordance with Czech legislation and IPSAS system. It tries to catch the essential differences that arise from the financial legislation, the accounting basis and also from the content of financial statements. The paper also indicates the difference between Czech Accounting Standards for selected accounting entities that maintain accounts in accordance with Decree No. 410/2009 Coll. and International Public Sector Accounting Standards (IPSAS). There is also recommended approach to the creation of national standards with regard to international harmonization.

public sector, international accounting standards, harmonisation, financial reporting

Since the beginning of 2010 many changes in the accounting of public service have been carried out in the Czech Republic. Financial reform is related to these changes. Output of this financial reform should be accounting system of the state, which can provide accurate, timely and relevant information about its financial situation. The implementation of accrual principle into the accounting of public administration, preparation of consolidated financial statements, that are completely new ideas, which are positively considered not only by the Czech Republic. Implementation of these elements into accounting of public sector has been promoted for several years by the International Federation of Accountants (IFAC), under whose patronage were created the International Accounting Standards for the public sector (International Public Sector Accounting Standards, IPSAS).

Public Sector Committee (PSC) was created in 1986. His task was to discover the needs of accounting of public sector under which IPSAS were gradually formed and issued. This committee was replaced in 2004 by International Public Sector Accounting Standards Board (IPSASB hereinafter), whose task is to generate in public interest high-quality financial reporting standards of public sector and to facilitate the process of convergence of national and international standards, thus improving the quality and consistency of financial reporting worldwide.

There are currently 26 IPSAS standards based on an accrual principle and a standard based on a cash basis. As mention Kotkova, Rokos and Schmidt (2007) in the very beginnings of the creation of IPSAS standards, there was selected from the content perspective a strategy that the standards will be fully accrued and for particular needs of less

developed countries will be issued also standards based on cash basis. Most IPSAS standards are corresponding to International Financial Reporting Standards IAS / IFRS, which formed the basis during the creation of IPSAS. Specific standards for the public sector are IPSAS 22 (Disclosure of financial information on the government sector), IPSAS 23 (Yields from the anconvertible transaction – taxes and transfers) and IPSAS 24 (Disclosure of financial information in the financial statements). We would not find equivalent of these standards at the IAS / IFRS. Accrual principle became the basis for IPSAS. The accrual principle according to IFAC (2008) is explained as follows: Accrual basis represents accounting basis according to which transactions and other events are reported when they occur (regardless of when the cash or its equivalent were received or paid). For this reason, transactions and events are recorded in the accounting records and reported in the financial statements for the periods to which they relate. Items reported under accrual principle are assets, liabilities, net assets / equity, revenue and expenses. Financial statements, as an outcome from accounting reflecting the accrual principle, has a higher explanatory power and can lead ultimately to better decision-making of accounting entity (eg. Government) on allocation of resources. Cash principle was also mentioned in addition to the accrual principle. In this regard, IFAC (2008) states: “The accounting based on cash basis records transactions and events only when an entity adopts or issue monetary resources (including cash equivalents).” With regard the fact that reporting of a number of countries is based on a cash basis, a specific IPSAS standard (Financial reporting on a cash basis) was created. This standard establishes requirements for financial statements in cases where the basis of the accounting entity is cash principle.

METHODS AND AIM

The aim of this paper is on the basis of description of the International Public Sector Accounting Standards (IPSAS) show the comparison of financial reporting in accordance with Czech legislation and in accordance with IPSAS system. The paper is devoted to the financial statements compiled on the basis of accounting, which is based on the accrual basis. It is primarily drawn from the IPSAS 1 and IPSAS 2. The actual financial statements can not be understood solely as a matter of mentioned two standards as other standards dealing with specific fields of accounting and provide the necessary requirements for reporting of items in the financial statements. Emphasis is placed on the various provisions of both accounting systems (International Accounting Standards for the public sector and the Czech accounting legislation). Observed differences are then evaluated with respect to changes in the field of accounting and reporting of accounting entities of public administrations which have been

implemented in the Czech Republic in connection with the reform in the field of public finances since 1. 1. 2010. A partial objective is to highlight the fundamental differences of Czech accounting standards for selected accounting entities that maintain accounts in accordance with Decree No. 410/2009 Coll. with International Public Sector Accounting Standards (IPSAS) and to recommend approach to the development of national standards with regard to international harmonization, so as to ensure comparability of national and international accounting standards and thereby to increase the credibility of financial information provided by entities of public sector worldwide.

The paper is processed using several methods of scientific work. It is a method of description, comparison, analysis and synthesis.

The first section deals with the implementation of international accounting standards IPSAS in the accounting of public sector in the Czech Republic and there are some general differences between the Czech accounting standards and IPSAS. It is here pointed to the introduction of accrual principle into accounting of the public sector in the Czech Republic and to the importance of IPSAS for the public sector. This section of the paper is processed using the method of description. The second part deals with requirements that are imposed on the financial statements in accordance with IPSAS and according to Czech accounting legislation. The central part of the paper identifies the main differences resulting from the comparison of financial reporting in the Czech Republic and financial reporting system in accordance with IPSAS. There are variations of these systems with regard to financial legislation, a different accounting basis and differences arising from the content of financial statements. Differences were first detected by the method of comparison and afterwards these identified differences were described on the basis of synthesis. All findings and facts are on the basis of synthesis summarized in summary.

RESULTS AND DISCUSSION

1 Implementation of IPSAS

IPSAS standards are developed to improve quality and presentation of the financial statements of the public sector. Reporting of adequate, understandable and comparable information is ensured through these standards. The benefits of standards Rokos (2004) expresses as follows: “The benefits of IPSAS is the existence of accounting standards, created from a highly professional manner and transparent process, which may be used by national accounting standard issuers as a convenient base for the needs of its accounting. Conformity of national accounting standards with international standards IPSAS, therefore their harmonization, facilitate comparability of data on financial position and performance in an

international scale. Using standards should help the aim of the financial statements, ie to satisfy the information needs of users.”

The implementation of IPSAS standards in their entirety is characteristic rather to international organizations like OECD, NATO, Interpol. In the case of individual countries the situation is less common. Countries generally retain autonomy in the process of developing their own accounting standards and they only take account of IPSAS standards. In the future, however, it is possible to expect some pressure, especially on the EU Member States. It may be noted to the above mentioned that the European Commission has been reported its financial statements in accordance with IPSAS standards since 2005.

The implementation of IPSAS are at the very beginning in the Czech Republic. The first important steps which moderate differences between accounting of Czech Republic and IPSAS standards can be indirectly linked with building a Treasury system and the ongoing financial reform. MINISTRY OF FINANCE (2006) in this context has previously stated: “Modelling of variants of the transition to accrual principles in accounting of public administration has been proceeding in preparation for the implementation of central accounting of state. The aim is in connection with financial reform to examine the impact of the implementation of international accounting standards and the introduction of accrual accounting in public administration.” Given that fact the Czech Republic is a member of the EU it will be necessary in the future to implement IPSAS into its accounting of public sector. The question remains to what extent, how and how fast.

Comparison of Czech accounting standards with IPSAS

Czech Accounting Standards (CAS) in contrast to IPSAS establish further description of accounting methods and accounting procedures. IPSAS does not address the accounting, but it is dealing with the reporting, evaluating and disclosure of accounting information. They are conceived completely unlike the Czech accounting legislation for the public sector, when the accounting of public sector is based on Act No. 563/1991 Coll. on Accounting, Decree 410/2009 Coll. CAS and others.

CAS are important for entities of public administration because they must take them into account during accounting. Specifically, this liability is established by Act on accounting, which in § 36 paragraph 1 states that the selected entities always proceed according to the standards. Creation of standards is entrusted to the Ministry of Finance which announces their release by the Financial newsletter. For entities that maintain its accounting in accordance with Decree No. 410/2009 Coll. there were in the Financial Bulletin 7/2009 published only four standards. These standards are:

- 1) CAS 701 Accounts and accounting principles in the accounts,
- 2) CAS 702 Opening and closing of accounting books,
- 3) CAS 703 Transfers,
- 4) CAS 704 Funds of the entity.

Other accounting standards had been published in the Financial Bulletin 8/2010. This is a change in CAS 703 transfers and on new standards CAS 705 *Reserves*, CAS 706 *Impairment and disposal of claims* and CAS 707 *Stocks*. Other accounting standards should be gradually issued during 2011. Given the fact that nowadays Czech Republic is in a period when other standards are created, it would be suitable to inspire with the International Accounting Standards IPSAS during their creation. If the national standards in the individual country were made up so that international accounting standards IPSAS would be their basis, there would be ensured a greater degree of comparability of data derived from accounting and reporting.

2 Requirements for financial statements and its components

Financial statement under ipsas based on the accrual basis

IPSAS standards establish requirements for financial statements in the case of application of accrual or cash principle in accounting. The paper will be devoted to the financial statements compiled on the basis of accounting resulting from the accrual basis. It will be primarily drawn from the IPSAS 1 and 2. The actual financial statements can not be understood solely as a matter of two mentioned standards. Other standards deal with specific fields of accounting and set the necessary requirements for reporting of items in the financial statements.

General requirements for financial statements provides IPSAS 1 – Presentation of Financial Statements. IFAC (2008) by IPSAS 1 provides that the complete financial statements includes the following components:

- a) Statement of financial position,
- b) Statement of financial performance,
- c) Statement of changes in net assets / equity,
- d) Statement of cash flows,
- e) If an entity publishes the approved budget, therefore budget structure, either as a separate financial statement or as a column in the accounting statement,
- f) Annotation containing a summary of significant accounting policies and other explanatory annotations.

The Standard also defines the general conditions of financial statements, which are a prerequisite for a fair presentation and compliance with IPSAS, the assumption of persistency of entity, assumption of consistency of reporting, the assumption of significance and aggregation, the assumption of

compensation, the assumption of comparable information.

Statement of financial position (balance sheet)

Balance sheet prepared in accordance with IPSAS could be classified, as in the Czech accounting, as an overview of assets and liabilities (standards are primarily using expression liabilities – the term “liabilities” does not occur in the standards). During drawing up the statement of financial position an entity should, in accordance with IPSAS, report separately short-term and long-term assets and short-term and long-term liabilities. Standard does not provide a binding form of a statement of financial position. It states only, that the statement should contain minimally information about items that shows below mentioned in Table I. Further it admits that it is possible to introduce additional lines in statement, if it will be necessary detailed division of items for reporting of more relevant information and for understanding the financial situation of entity. A more detailed division of items is necessary to introduce, however into the annotation to financial statements.

Statement of financial performance (income statement)

Classification of costs, profits and surplus (or deficit) is characteristic for this statement. IPSAS 1 also does not prescribe the form and structure of the

statement. The statement should include at least the lines set out in below mentioned Table II.

Entity must disclose, in the statement or in the annotations, cost analysis using the classification of either type, or the purpose of costs to meet all the requirements of IPSAS 1 that places on statement of financial situation.

Statement of changes in net assets/equity

This is another essential part of these financial statements. The term “net assets / equity express the” residual share in the assets of an entity after deducting all its liabilities.

Statement of Cash Flows

Creation of the mentioned statement is very important, since information about cash flow helps users to anticipate future needs of the entity, its ability to generate future cash flows and fund changes in the extent and nature of their activities. The requirements on the structure of the statement of cash flows are adjusted under IPSAS 2. It states that the statement should include a division of cash flows from operating activities, investing activities and financing activities. It states that an entity should report cash flows by direct, or, indirect method. But however there is recommendation for using the direct method.

I: Information published in statement of financial situation

- | |
|---|
| a) Lands, buildings and equipments |
| b) Investments in real estates |
| c) Intangible assets |
| d) Financial assets (excluding the letters e, g, i) |
| e) Investments reported under the equity method |
| f) Stocks |
| g) Claims arising from anconvertible transactions (taxes and transfers) |
| h) Cash and cash equivalents |
| i) Liabilities from taxes and transfers |
| j) Liabilities of foreign exchange transactions |
| k) Reserves |
| l) Financial liabilities (excluding the letters j, k and l) |
| m) Minority shares reported in net assets / equity |
| n) Net assets / equity attributable to owners of controlling entity |

Resource: IFAC (2008)

II: Information published in the statement of financial performance

- | |
|---|
| a) profits |
| b) financial expenses |
| c) share on the net surplus or deficit of associates and joint ventures reported using the equity method |
| d) gains or losses before tax reported on disposal of assets or payment of liabilities attributable to determining operations |
| e) surplus or deficit |

Resource: IFAC (2008)

Annotations

Further necessary information, which contribute to a better presentation of the financial statements are included in this part of the financial statements. In the annotation there should be given data about specific accounting rules and information that are not listed in the above described statements, or additional information, that is relevant for an understanding of any of the items of financial statements. Standard IPSAS 1 introduces further requirements on the structure of the annotations.

Financial statements in accordance with Czech accounting legislation

The duty of the compilation of financial statements is established in Act No. 563/1991 Coll. on Accounting. This law states that the information contained in the financial statements must be reliable, comparable, understandable and meaningful. Relevant implementing regulation establishes specific requirements of the form of financial statements for the individual entity. This regulation is for entity of public sector *Decree No. 410/2009 Coll., which implements certain provisions of Act No. 563/1991 Coll. On accounting, as amended, for some selected entity.*

The term "selected accounting entity" includes government departments, state funds, the Land Fund of Czech Republic, local authorities, voluntary associations of municipalities, the Regional Council of cohesion, allowance organizations and health insurance.

The financial statement of selected entities is created by:

- a) Balance sheet,
- b) Profit and loss statement,
- c) Annex,
- d) Statement of cash flows,
- e) Statement of Changes in Equity.

Cash flow statement and statement of changes in equity are compiled by selected units with effect from 1. 1. 2010.

3 Main differences resulting from the comparison of financial reporting in the Czech republic and under IPSAS

At this point, a brief comparison of financial reporting in accordance with Czech legislation and in accordance with IPSAS system will be made. Attention will be paid on differences resulting from accounting legislation, from different accounting bases and from different content of financial statements. Particularly the following legislation is meant by Czech law:

- Act No. 563/1991 Coll. on Accounting, as amended,
- Decree No. 410/2009 Coll., which implements certain provisions of Act No. 563/1991 Coll. on accounting, as amended, for some selected entity,

- Czech accounting standards for some selected entities which maintain accounting pursuant to Decree 410/2009 Coll.

Differences due to accounting legislation

The field of reporting of public administration includes in the Czech Republic in particular, accounting and financial statements. Compilation of financial statements is generally treated with the Accounting Act, the implementing decree and Czech accounting standards. The duty to compile financial statements implicates the existence of other decrees and laws. Thus, there is not one binding regulation. In contrast, IPSAS comprehensively regulate the entire financial reporting. In this respect it is interesting to note the importance of Czech accounting standards. If we seek an agreement with the IPSAS standards, then we have to focus on CAS No. 501–522, which do not show too much in common. It should be noted, however, that these standards applied only to the end of 2009. From 1. 1. 2010 came into effect a new CAS No. 701–704, subsequently CAS 705, 706 and 707 were issued. Neither these standards have significant compliance with IPSAS. Czech accounting standards are primarily designed to establish accounting procedures. On the other hand IPSAS do not solve the field of accounting, but rather they meet the general requirements relating to the recognition, evaluation and reporting of items in the financial statements.

Differences resulting from different accounting basis

IPSAS standards, as already mentioned, are based on the accrual basis. In connection with the reporting of public administration in the Czech Republic, however, it is not possible to speak of full accrual accounting and financial statements prepared on an accrual basis. For the public administration is not critical balance sheet and profit and loss statement, as in the case of businesses. Statement for evaluation and fulfilment of budget is the core information on the management of an entity. This statement is compiled according to the current budget structure, which reflects the cash principle. Considering the fact that the field of accounting is associated with the field of budget through a system of synthetic accounts, accounting of public sector is rather specific. The actual chart of accounts, under which the entity compiles its chart of accounts and subsequently accounts, included until the end of 2009 synthetic accounts of budget management. These accounts are also reflected in the items of balance sheet. From this perspective, it can not be considered a financial reporting of public sector for full accrual.

A fundamental change raises the current financial reform of public sector, through which they are gradually since 1. 1. 2010 introduced new, accrual elements into the field of accounting and reporting

of public sector. Entities will newly carry out distinction of expenses and income, depreciation of fixed assets, creation of provisions to fixed assets and claims, the creation of reserves, etc. This will gradually be fulfilled accounting principle of a fair display of reality. Application of the above mentioned accounting methods and procedures required modification of synthetic accounts of chart of accounts and also the change in accounting financial statement. At present we can speak about some approach of accounting to business entities. Adoption of accrual principle in accounting does not reflect during the compilation of statement for the evaluation and fulfillment of the budget, which continues to reflect the cash principle of budgetary structure. We can say that the gradual introduction of the accrual basis into accounting of public administration will moderate one of the major differences of Czech accounting regulation and the IPSAS.

Differences resulting from content of financial statements

In the Czech Republic Decree No. 410/2009 Coll. provides precise requirements for the content of the individual items of financial statements. In the case of financial statements so it is the Decree No. 449/2009 Coll. Part of both two regulations are also binding patterns of statements for selected entity. IPSAS do not include any binding patterns. Only illustrative formats of financial statements are listed there. Standards provide general information and items that should be shown in particular accounting statements. Financial statements must be based on defined assumptions and should primarily be understood by their users. For this reason it is preferred that the compiled financial statements would include only basic items. Further necessary additional information is then reported in the annotations of financial statements. Annotation in accordance with IPSAS are more detailed and extensive compared with an annex, that is one part of the financial statements in the Czech Republic.

With regard to the part of the financial statements can be concluded that both systems consistently refer to the duty of compilation of balance sheets, profit and loss statement, the Annexes (annotations), the cash flow statement and statement of changes in equity. In the individual financial statements of both two systems appear similar items that differ for example in notation. Also it should be noted that the we can speak of similarities in different parts of the financial statements of Czech legislation and IPSAS only since 2010 and in connection with the mentioned accounting reform of public administration. One of the new statements, which an entity has to compile as early as 2010 is the cash flows statement. IPSAS prefer compilation of the cash flow statement by direct method. They do not exclude the compilation of statement by an indirect method. Nowadays we can observe an interesting fact in the Czech Republic. The role of cash flows statement, corresponding to the direct method of preparation, meets in certain way a statement for the evaluation and fulfilment of budget. New duty for an entity is compilation of the cash flow statement by indirect method. It is therefore questionable whether this new part of the financial statements will be meaningful and beneficial. Another difference can be seen in the balance sheet. It relates to the separate reporting of long-term and short-term assets and liabilities, where are different criteria under which the division occurs. Czech legislation divides the assets and liabilities into groups according to usable life which is distinguished until 1 year and over 1 year. According to IPSAS asset it is reported as a short-term if its implementation is expected during the normal operating cycle of entity or is primarily held for the purpose of trading or its realization is expected within twelve months after the reporting date. The liability is recorded as short-term if its payment is expected within the normal operating cycle of entity or is primarily held for trading with him or is payable within twelve months after the reporting date. All other assets and liabilities are reported as long-term.

SUMMARY

The aim of this paper was on the basis of description of the International Public Sector Accounting Standards (IPSAS) indicate the comparison of financial reporting in accordance with Czech legislation and in accordance with IPSAS system. By comparing there were identified the differences for the field of accounting legislation and those arising from the accounting basis and content of financial statements.

Based on a comparison of accounting legislation can be said that in the Czech Republic there is not one binding legislation that would regulate the whole field of financial reporting. Field of reporting of public administration in the Czech republic is regulated by several laws, decrees and CAS. IPSAS comprehensively regulate the entire field of financial reporting.

IPSAS are based on the accrual basis. Financial reform in the field of public finance was launched from 1 January 2010 in the Czech Republic. This reform means the introduction of accrual principle into accounting of public administration.

For an entity of public administration the accounting has changed, which was based on the cash principle and accrual basis became characteristic for them. At present, we can talk about some

approach of the systems. The adoption of accrual principle into accounting of the public sector in the Czech Republic, however, does not affect the compilation of statement for the evaluation and fulfillment of the budget, which continues to reflect the cash principle of budgetary structure. Given that the field of accounting is associated with field of the budget through a system of synthetic accounts, accounting of public sector is slightly specific. Implementation of the accrual basis into accounting of public administration moderates one of the major differences of Czech accounting legislation and the IPSAS.

In the Czech Republic there are defined precise requirements for the content of the individual items of financial statements. In decrees we can also find binding patterns of statements for selected entity. In the IPSAS there are only illustrative formats of financial statements. Parts of the financial statements are the same for both systems. It is a balance sheet, profit and loss statement, annex (annotation), cash flow statement and statement of changes in equity. Also it should be noted that we can speak of similarities in different parts of the financial statements of Czech legislation and IPSAS only since 2010, and in connection with the mentioned accounting reform of public administration. The difference can be seen in the compilation of the cash flow statement. IPSAS prefer compilation of the cash flow statement by direct method (but they do not exclude compilation by an indirect method). Cash flow statement is compiled by indirect method in the Czech Republic. The role of cash flows statement, corresponding to the direct method of preparation, meets in a certain way, a statement for the evaluation and fulfillment of budget. Therefore, I believe that the new part of the financial statements in the form of cash flow statement will not be very useful and beneficial. In connection with the reporting of long-term and short-term items of assets and liabilities of balance sheet there are different criteria according to which introduced division occurs. Czech legislation divides the assets and liabilities into groups according to usable life, which is distinguished until 1 year and over 1 year. Under IPSAS, the item is reported as short-term, if we expect realization of the asset or payment of a liability during the normal operating cycle of entity or within twelve months after the reporting date. If an asset or liability is held for the purpose of trading so the item is reported as short-term. All other assets and liabilities are reported as long-term.

From the above introduced comparison revealed several differences in the financial statements in accordance with Czech legislation and in accordance with IPSAS system. These are significant differences, their removal requires intervention, especially in accounting and other related legal standards. Currently the ongoing reform of public administration moderates in some way certain differences between both systems. Czech Republic should decide to undergo changes with respect to the implementation of IPSAS in the accounting of public sector as far as possible, as it can be expected pressure in future with regard to this implementation, given that the Czech Republic is member of European Union.

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